AMERICAN BANKER

Five Post-Election Questions on Bank Policy

Rob Blackwell, Joe Adler – 11/8/2012

WASHINGTON - After months of handwringing, large political donations and the most aggressive push in history by bankers against an incumbent president, the industry now faces a world almost exactly the same as the one before the election season started.

President Barack Obama will remain president, Republicans still control the House and Democrats - against all odds - actually added to their Senate majority.

This mostly status quo election is a severe blow to bankers, who had hoped Republican victories would help them revise the Dodd-Frank Act and usher in more bank-friendly regulations.

It also raises a host of questions about what happens next, covering everything from the mortgage interest deduction to a renewed legislative drive to break up the largest banks.

We offer the following critical questions facing banks in the post-election environment:

1) Will the election spur a big bank breakup?

One of the early predictions following Tuesday's election was that it may embolden lawmakers who favor capping the size of banks. Democratic Sen. Sherrod Brown, a key proponent of that idea, won reelection and will be joined by Elizabeth Warren, a longtime bank critic seen as sympathetic to a big bank breakup.

Yet the idea is also popular in some conservative circles, raising questions about whether Democrats and Republicans could actually work together on big-bank downsizing.

"Advocates of big-bank break-ups have gained a new edge," wrote Karen Shaw Petrou, managing partner of Federal Financial Analytics, in an e-mail to reporters. "Progressive Democrats don't agree with populist Republicans on much but their shared belief that big banks remain too big to fail. I think this will be among the most aggressive reform items on Congress' agenda early in the new year, one with considerable political potential."

Camden Fine, the president of the Independent Community Bankers of America, agreed.

"The idea of some sort of downsizing of the too-big-to-fail banks will gain much more traction, and if there is another major scandal "\xA6 then I think there is a real possibility that the Congress would move to make structural changes in the too big to fail banks," he said.

Yet there are signs that President Obama is unlikely to pursue such a plan. For one thing, he has enough on his agenda already - including the pending fiscal cliff, tax reform and the future of housing finance - that he is unlikely to embrace another major financial reform initiative.

Secondly, in an interview last month(http://www.rollingstone.com/politics/blogs/taibblog/obama-defends-his-finance-reform-record-to-rolling-stone-a-brief-response-20121026) with Rolling Stone, Obama suggested he didn't favor a bank breakup by rejecting the idea that repeal of the Glass-Steagall Act caused the crisis.

"The problem in today's financial sector can't be solved simply by re-imposing models that were created in the 1930s," Obama said.

Another key question is who Obama will choose as his next Treasury secretary. Tim Geithner has made it clear he plans to leave, but it's unclear who will succeed him. While Geithner did not favor a big bank breakup, his successor might, and could potentially convince Obama it's an idea worth pursuing.

2) What happens to the mortgage interest deduction?

House Speaker John Boehner wasted no time on Wednesday trying to engage Obama on a possible debt deal, saying he was open to raising government revenues in return for comprehensive tax reform.

One of the top ideas on the table is to eliminate or limit the tax deduction for mortgage interest payments - a plan the housing industry opposes.

"It's absolutely on the table and I think there is a better chance now of limiting the mortgage interest deduction than there ever has been," said Isaac Boltansky, an analyst at Compass Point Research and Trading. "We are for the first time in the history at a point where there can be a serious discussion about limiting it."

Most observers said eliminating the deduction was unlikely, but capping it was a distinct possibility.

"I don't think elimination of the mortgage deduction is going to pass," said Richard Hunt, president and chief executive of the Consumer Bankers

Association. "There are only so many things you can do while the economy is still in a very tenuous state. I think maybe they'll means test it or put caps on it, but I don't think you'll see its elimination."

3) When will Obama and Congress take up housing finance reform?

A big unresolved issue from 2008 is what to do with Fannie Mae and Freddie Mac, which were put into conservatorship with the idea that policymakers would chart a new future for them.

So far, however, no one has appeared interested in taking up the issue. House Republicans complained about inaction prior to 2010, but once they seized control of the chamber they largely stopped mentioning the issue.

The Treasury Department, meanwhile, outlined three vague options for reform in 2011 - and then declined to say which one it preferred. Geithner promised more details on a plan last spring, but never followed through. Since he is on the way out, it's unclear when the issue will be addressed.

"There's no mandate from this election to do anything about Fannie and Freddie," said Jaret Seiberg, a managing director at Guggenheim Partners. "It's almost impossible to see quick action by the Congress and the White House."

4) Does Dodd-Frank implementation speed up?

Although regulators claim not to be caught up in presidential politics, many observers argue the banking agencies have been holding off on finalizing controversial provisions of Dodd-Frank until after the election.

The Consumer Financial Protection Bureau, for example, has repeatedly delayed finalizing a rule defining "qualified mortgages" that would be exempt from a requirement that lenders to ensure borrowers have the ability to repay a loan.

Regulators are widely expected to move forward shortly on many outstanding issues, including QM, its sister regulation defining "qualified residential mortgages" and the Volcker Rule ban on proprietary trading.

"What we have from this election is a reinforcement of the Dodd-Frank Act, and that we will continue down this path," said Boltansky. "It means we will have the full enactment of Basel III, it means we'll have the finalization of the Volcker Rule, it means this year we're going to have QM and QRM done. ... We were going down a road yesterday and there was an exit off of the Dodd-Frank rulemaking highway. Americans decided to stay on the highway."

But others are hopeful that freed from campaign politics the administration may encourage regulators to dial back on certain regulations for fear they could harm the economy.

"Reelection could give them the benefit of perhaps recognizing unintended consequences and adapting accordingly," said John Bowman, a partner at law firm Venable and former acting director at the Office of Thrift Supervision. "I don't know that implementation will speed up. The issues that are still out there are very complicated. There are a number of consequences that I think the regulators, and hopefully various people on Capitol Hill, are coming to appreciate are going to have unintended results."

Mark Calabria, director of financial regulation studies at the Cato Institute, agrees that the administration now has more flexibility to take a closer look at some of the implications of various rules.

"Obama's reelection is an affirmation of "healthcare [reform and] Dodd-Frank," Calabria said. "I think Democrats think these things are secure enough you can move from defensive posture to how do we make things work."

5) Can Democrats and Republicans work together?

While the Senate Banking Committee keeps its chairman, Tim Johnson, the other three leadership spots on the House and Senate banking panels are all expected to change hands.

Sen. Mike Crapo, R-Ida., is expected to succeed(http://www.americanbanker.com/issues/177_194/will-crapo-take-over-as-banking-panels-top-republican-1053311-1.html) Sen. Richard Shelby as the banking panel's lead Republican. That may bode well for cross-the-aisle cooperation as Crapo is seen as more low-key than Shelby. Observers have predicted that Crapo and Johnson are likely to get along, considering both are from states with a significant number of small banks.

The situation in the House Financial Services Committee, however, is potentially more volatile. Rep. Jeb Hensarling, the outspoken free-market conservative from Texas, is expected to chair the committee, while Rep. Maxine Waters, the liberal stalwart from California, is likely to be the panel's chief Democrat.

While Waters has already said she would like to cooperate with Hensarling, many observers wonder if that is possible.

"On the one hand, I think they are going to work together better than people expect, because I think the expectation is quite low," said Calabria. "Neither one of them would be described as a moderate. Both can be combative, both can be very strong willed. You can certainly expect some clashes, but on the other hand I actually expect a fair amount of cooperation then I think people would expect."

Victoria Finkle and Donna Borak contributed to this article.